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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1940

No. 224

FRED P. HAYWARD ET AL.,
Petitioners,

vs.

CITY OF CORPUS CHRISTI.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

DAVID M. WOOD,
MARCELLUS ECKHARDT,
Counsel for Petitioners.

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SUPREME COURT OF THE UNITED STATES

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No. 224

FRED P. HAYWARD ET AL.,

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vs.

CITY OF CORPUS CHRISTI.

PETITION FOR WRIT OF CERTIORARI.

May it please the Court:

The petition of Fred P. Hayward, Fred W. Hubbell and Francis P. Sears respectfully shows to this Honorable Court:

A.

Summary Statement of the Matter Involved.

This petition presents for review the refusal of the United States Circuit Court of Appeals for the Fifth Circuit, to recognize as final a prior judgment rendered by a State court in Texas in an action involving the identical subject matter and issues between the same parties or their privies and the failure of the United States Circuit Court of Ap-

peals to apply to the case at bar the law of the State of Texas as expounded by decisions of the courts of that State.

On September 24, 1932, one Harris, a taxpayer of the City of Corpus Christi, Texas, filed a petition in the 117th Judicial District Court of Nueces County, Texas, seeking to enjoin the City of Corpus Christi from making further payments upon three outstanding series of bonds of that city, being the bonds sued upon in the case at bar, upon the grounds that the bonds had been illegally issued and were void (R. 93-117). The petition was filed by Harris, in his capacity as a taxpayer of the City of Corpus Christi, on behalf of himself and on behalf of the City of Corpus Christi, and in addition to seeking an injunction also prayed that damages be recovered in favor of the City of Corpus Christi against the various defendants, named in that suit, for breach of contract and for payments theretofore made on account of such outstanding bonds and that the bonds be declared void. The bonds which were the subject matter of that suit and which are also the subject matter of this suit, were obligations of the city payable out of the revenues of the city's water system and were secured by trust indentures between the city and three separate trustees (R. 593-627, 636-669, 758-803). In his suit Harris named as parties defendant various members of the governing body of the city and their predecessors in office, as well as the city itself, the contractor to whom the bonds were originally issued and the three trustees appointed by the indentures securing the bonds. The trustees for the bondholders in that suit attacked the petition of the taxpayer by general demurrer and also by special exceptions going to the merits of the case and the right of Harris to maintain the suit (R. 899-934, 319-320). The city answered the petition by stating that it was holding the revenues of the water system "to abide the judgment of the court" and that it stood "ready and

willing to abide the judgment of the court on final determination of the said suit" (R. 117-119). After many amendments to the petition had been allowed the case was finally disposed of on the taxpayer's fourth amended petition and the trustees' general demurrer and special exceptions, and the court rendered its judgment sustaining separately the general demurrer and special exceptions and dismissing the taxpayer's petition with leave to further amend expressly denied (R. 472-474). The taxpayer appealed from the judgment of the lower court to the Court of Civil Appeals and the City of Corpus Christi, pursuant to a resolution of its City Council, filed with the Court of Civil Appeals its motion requesting that the judgment of the trial court be reversed and by that motion expressly joined in all the requests and briefs filed by the taxpayer (R. 474-475, 120-124). The Court of Civil Appeals affirmed the judgment of the lower court "in all things" (R. 140) and rendered an opinion reported as *City of Corpus Christi* v. *Flato*, 83 S. W. (2d) 433 (R. 125-138, Appendix 2). A writ of error to the Supreme Court of the State of Texas sued out by the taxpayer was dismissed by that court (R. 476).

After the decision in the taxpayer's action the city paid interest on the bonds but failed to pay the interest installment due February 1, 1937, and thereafter the petitioners in the case at bar filed the instant suit against the city in the United States District Court for the Southern District of Texas to recover judgment upon the February 1, 1937 interest coupons appurtenant to the identical bonds involved in the taxpayer's action. The trial court awarded judgment in favor of petitioners (R. 178) predicated upon its findings of fact and conclusions of law (R. 146-178). The Circuit Court of Appeals reversed that judgment, holding the decision of the Texas Court of Civil Appeals rendered in the taxpayer's action to be mere *obiter dictum* and the

judgment in the taxpayer's action not to be conclusive because, in the opinion of the Circuit Court of Appeals, the principles of law upon which the judgment had been predicated, were overruled in a later State court decision rendered in a different case (R.1040-1043).

The bonds had been issued by the city for the purpose of acquiring additional water powers pursuant to Articles 1111 to 1118, Revised Civil Statutes of Texas, 1925, as amended (Appendix 1). The city received full value for the bonds (R. 460-465). There is no claim of fraud in the issuance of the bonds or lack of consideration. The bonds were originally issued in three series, one series aggregating $2,000,000, dated August 1, 1927 (R. 583-592), one series aggregating $350,000, dated August 1, 1928 (R. 627-635), and one series aggregating $375,000, dated September 1, 1929 (R. 670-691). All three series of bonds were issued in pursuance of a contract entered into between the City of Corpus Christi and Smith Bros., Inc. (R. 580-582, 737-742), for the purpose of acquiring an impounding and storage reservoir, a filtered water reservoir, a pumping station and elevated water tank or tower, as well as the necessary appurtenances thereto and reinforcement of the water mains to accommodate the additional water supply resulting from the aforementioned projects, and to provide sufficient moneys for the purchase by the city of the lands needed for each of such purposes. Thereafter, the City of Corpus Christi authorized an issue of Waterworks Revenue Refunding Bonds aggregating $725,000, dated September 2, 1929, for the purpose of refunding the $350,000 of bonds of the series of 1928 and the $375,000 of bonds of the Series of 1929 (R. 742-756). The entire series of 1929 and all but $290,000 of the series of 1928 were refunded by this issue (R. 161). Each series of bonds was secured by a trust indenture made between the City of Corpus Christi and a bank or trust company, conveying for the benefit of the hold-

ers of the respective series of bonds, a first lien upon the waterworks system of the City of Corpus Christi, and upon the net revenues of that system and appointing such trust company trustee for the bondholders (R. 593-627, 636-669, 758-803).

The bonds were delivered to Smith Bros., Inc., the contractor, from time to time as the contract was performed and were resold by Smith Bros., Inc., to bond dealers who distributed them widely among various parties, who purchased them prior to their maturity at prices in excess of their par value and without notice of any defect or infirmity therein (R. 162, 213-214, 216, 252-253, 274-284). The entire contract was completed by Smith Bros., Inc., and the work was formally accepted by the City of Corpus Christi by ordinance of its City Council (R. 460-465). Thereafter, a portion of the dam constructed by Smith Bros., Inc., for the purpose of creating the impounding reservoir under the contract above mentioned was damaged. The damaged part of the dam measured approximately 200 feet. The entire dam measured approximately 4,000 feet (R. 263-264). Thereupon the city applied to the Reconstruction Finance Corporation for a loan to enable it to repair the damage to the dam and to improve it by installing sluice gates in that part of the dam which was damaged. The Reconstruction Finance Corporation advised the city that it might obtain such a loan provided the holders of the then oustanding bonds agreed to certain conditions, among which was a waiver by the holders of such bonds of their prior lien upon the waterworks plant of the city and upon its net revenues (R. 217-218). In order that such a waiver might be obtained from the holders of the outstanding bonds the petitioners, together with Robert L. Fischer and Natt T. Wagner, constituted themselves members of a committee of holders of the outstanding bonds, under a Deposit Agreement, dated November 10, 1932, and amended December 6, 1932

(R. 426-450). Robert L. Fischer resigned in 1932 and was succeeded by Leslie R. Martin, who later resigned. Natt T. Wagner also resigned as a member of the committee and the vacancies in the membership of the committee created by these resignations were never filled, leaving the petitioners the only members of the committee (R. 222, 231).

On or about March 10, 1933, the City of Corpus Christi adopted an ordinance (R. 466-471) reciting that the Reconstruction Finance Corporation had agreed to purchase from the city $500,000 of its Water Plant Repair Revenue Bonds for the purpose of enabling the city to repair the damage to the dam, above referred to, upon the condition, however, that a plan of readjustment, satisfactory to the Reconstruction Finance Corporation, be formulated by the above mentioned bondholders' committee and upon the plan being made effective and binding upon the holders of the city's then outstanding bonds which were secured by liens upon the city's waterworks plant and upon its net revenues. The ordinance further recited that the holders of outstanding bonds of each of said three series had deposited such bonds with the bondholders' committee, under the Deposit Agreement, in amounts satisfactory to the Reconstruction Finance Corporation, and thereby subjected their bonds to the plan of readjustment, and, to consummate such plan of readjustment, it was necessary to amend the indentures securing the outstanding bonds of each series by executing supplemental indentures stating the modifications and changes of said outstanding bonds made by the plan of readjustment. Thereafter the city executed three, separate, supplemental indentures, each dated as of February 1, 1933, with the banks and trust companies, which were named in the respective indentures, securing the three series of outstanding bonds above mentioned (R. 491-514, 537-557, 515-536). Each of the supplemental indentures referred to provided that the lien of the outstanding bonds was subordinated to

the lien of $500,000 Water Plant Repair Revenue Bonds to be issued by the City of Corpus Christi to the Reconstruction Finance Corporation; that the interest rate on the bonds of each said series was modified so that interest maturing after August 1, 1932 and prior to February 1, 1946 would be payable at the rate of four per cent in cash and the remaining two per cent in non-interest bearing scrip, which would be payable only as and when there existed surplus sinking fund moneys and not otherwise. Reductions were made in the sinking fund requirements for the bonds of each of said series and the maturities of the bonds of each of said series were postponed and the bonds made subject to redemption prior to their maturity.

As provided in the supplemental indentures, the bonds and the coupons attached thereto were stamped with endorsements evidencing the changes and modifications in their terms provided by the supplemental indentures. The Reconstruction Finance Corporation thereupon made its loan to the City of Corpus Christi by purchasing $500,000 Water Plant Repair Revenue Bonds. The city paid interest upon the outstanding subordinated bonds of the three series above mentioned, at the reduced rate and in accordance with the terms of the plan of readjustment until February 1, 1937 when it refused to pay the interest at the reduced rate, due that date, whereupon petitioners filed their complaint in this action to reduce such interest claims to judgment (R. 30-72). The defendant City of Corpus Christi filed an answer (R. 72-87) setting forth various defenses, among which were that Articles 1111 to 1118 inclusive, of the Revised Civil Statutes of Texas 1925 were not applicable to the City of Corpus Christi, and that, if such sections were applicable, the bonds were invalid for the reason that they had not been voted by the qualified voters of the city,—the identical objections raised in the taxpayer's suit in the State court. The petitioners filed a reply (R. 88-139) to the de-

fendant's answer pleading that the issues raised in this case had been finally and conclusively adjudicated in the taxpayer's suit in the State court; that the City of Corpus Christi had received, and was retaining the properties, which it acquired as a result of the issuance of the three series of bonds above mentioned, and that it had made no offer of restitution of these properties and that under such circumstances the city was estopped to deny its liability upon the bonds, through the issuance of which it acquired such properties; and that the city was estopped to assert the defenses interposed by its answer by virtue of recitals contained in the bonds and by virtue of its continued recognition of the validity of the bonds through the payment of the interest thereon and the readjustment thereof as provided in the aforesaid supplemental indentures. The disposition of the case by the District Court and the Circuit Court of Appeals has heretofore been set forth.

B.

Statement of the Basis of the Court's Jurisdiction.

1. This Honorable Court has jurisdiction to review the judgment of the Circuit Court of Appeals for the Fifth Circuit, by virtue of the provisions of Section 240(a) of the Judicial Code as amended (28 U. S. C. A. Section 347a). Federal jurisdiction is based upon diversity of citizenship (R. 147).

2. The date of the judgment of the Circuit Court of Appeals to be reviewed is April 20, 1940 (R. 1043). Appended hereto is a copy of the opinion of the Circuit Court of Appeals (Appendix 3). On June 13, 1940, rehearing was denied by the Circuit Court of Appeals (R. 1057).

3. Appended hereto is the opinion of the Texas Court of Civil Appeals in the companion case of *City of Corpus Christi* v. *Flato* (Appendix 2).

4. This is a proper case for the exercise by this Court of its power of review (*Erie Railroad Co.* v. *Tompkins*, 304 U. S. 64). Additional authorities are cited in the brief.

C.

Statement of the Questions Presented.

1. Did the Circuit Court of Appeals for the Fifth Circuit err in holding that the prior judgment of the State court rendered in *City of Corpus Christi* v. *Flato*, 83 S. W. (2d) 433, was not *res judicata* of the issues involved in the case at bar?

2. Did the Circuit Court of Appeals for the Fifth Circuit err in holding that the decision of the State court in *City of Corpus Christi* v. *Flato, supra,* was not binding upon it because it was merely *obiter dictum* and was later overruled by a decision of the Supreme Court of Texas, rendered in another case?

3. Did the Circuit Court of Appeals for the Fifth Circuit err in holding that the City of Corpus Christi was not estopped to deny the validity of the bonds by virtue of accepting and retaining the benefits received by it from the issuance of such bonds?

4. Did the Circuit Court of Appeals for the Fifth Circuit err in holding that the City of Corpus Christi was not estopped to deny the validity of the bonds by virtue of its affirmative action in the case of *City of Corpus Christi* v. *Flato, supra,* and by its continued recognition of the validity of such bonds through the payment of interest thereon, its dealings with the bondholders at the time such bonds were subordinated to the bonds sold to the Reconstruction Finance Corporation, and by the recitals of due and proper action contained in each of the bonds?

5. Did the Circuit Court of Appeals for the Fifth Circuit err in holding the bonds invalid upon the grounds that Articles 1111 to 1118, Revised Civil Statutes of Texas 1925, as construed by the State courts, required the bonds to be voted by the qualified voters of the City of Corpus Christi?

D.

Reasons Relied on for Allowance of the Writ.

1. The decision of the Circuit Court of Appeals that it was not bound by the decision of the State court in *City of Corpus Christi* v. *Flato, supra,* is violative of Section 34 of the Federal Judiciary Act (28 U. S. C. A. Sec. 725).

2. The decision of the Circuit Court of Appeals holding that that part of the judgment rendered upon the merits in the case of *City of Corpus Christi* v. *Flato, supra,* was *obiter dictum,* is in conflict with the decisions of this Court, the Courts of Appeals of other circuits, the courts of the State of Texas and with the weight of authority throughout the country. In fact it is in conflict with every decided case, which your petitioners have been able to discover, after a most painstaking investigation of the authorities.

3. The decision of the Circuit Court of Appeals holding that the judgment in *City of Corpus Christi* v. *Flato, supra,* was not binding upon it because the judgment was that of an intermediate appellate court and was overruled by a later decision of the Supreme Court of Texas, rendered in a different case, is in conflict with the decisions of this Court, of the Courts of Appeals of other circuits, of the courts of the State of Texas and with the great weight of authority throughout the country.

4. In refusing to affirm the decision of the United States District Court that the City of Corpus Christi was estopped to deny the validity of the bonds by accepting, holding and enjoying the benefits received from the issuance of the

bonds, the Circuit Court of Appeals has held directly contrary to the decisions of the Supreme Court of Texas, which are binding upon the Federal courts, under the decision of this Honorable Court, in the case of *Erie Railroad* v. *Tompkins*, 304 U. S. 64.

5. In refusing to affirm the decision of the United States District Court that the bonds are legal and valid obligations, the Circuit Court of Appeals has rendered a decision in conflict with the decision in the case of *City of Corpus Christi* v. *Flato, supra*, which the Supreme Court of Texas refused to reverse, thus resulting in the identical bonds being held invalid by the Federal court and valid by the State court.

WHEREFORE, your petitioners respectfully pray that a writ of certiorari be issued out and under the seal of this Honorable Court directed to the United States Circuit Court of Appeals for the Fifth Circuit, commanding that court to certify and send to this Court for review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its Docket No. 9213, *City of Corpus Christi, Appellant* v. *Fred P. Hayward et al., Appellees*, and that the said judgment of the United States Circuit Court of Appeals for the Fifth Circuit may be reversed by this Honorable Court and that your petitioners may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioners will ever pray.

FRED P. HAYWARD,
FRED W. HUBBELL,
FRANCIS P. SEARS,
Petitioners;
DAVID M. WOOD,
MARCELLUS G. ECKHARDT,
Counsel for Petitioners.